Perils and Pre-requisites in Deciding to Bring in Private Partners

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Four Questions

1. Does the Water District have clear service level improvement targets and does it have an estimate of how much this would cost if it were done in-house?

2. Is there vigorous competition for the right to invest in and contribute to the operation of water district assets — that would ensure that cost savings are realized?

3. Are there groups powerfully motivated and equipped to monitor private sector compliance with Key Performance Indicators KPIs ?

4. Are there regulators or local authorities with the incentive to take action (e.g., impose rewards and penalties) that respond to reports of (under)performance?

Some CoA Observations of Water Joint Ventures reveal problems:

Unsolicited Proposals tend to be the rule — some water districts have not determined that they needed to enter into a JV when they sat down to negotiate and clinch a deal with the proponent;

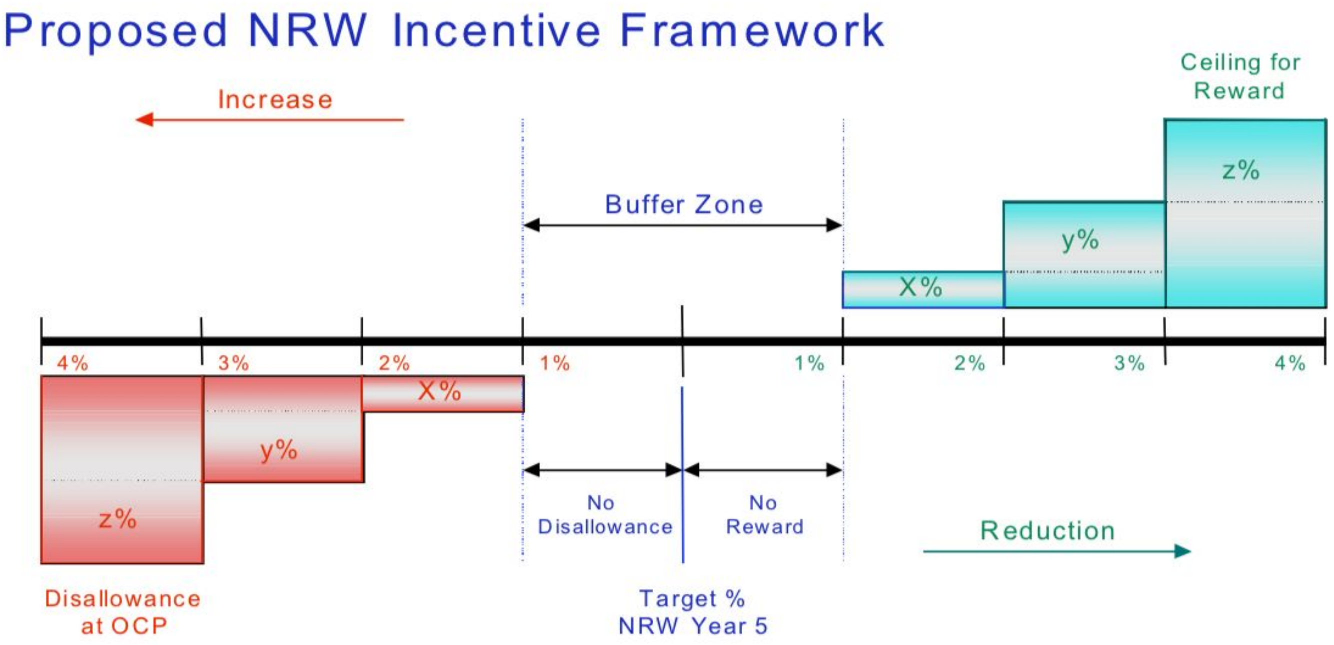
> i.e., the WD did not have a clear idea of what it wanted to procure and had no estimate of the required expense (e.g., tariff adjustment) if it implemented the service level improvements;

Some JV agreements were clear on the proposed investments and operations budgets (which will need to be reimbursed) — but have no Key Performance Indicators (KPIs);

Contracts that had KPIs seldom had penalties or reward clauses for missing or exceeding KPIs. The Zamboanga City WD JV for bulk water may be one of very few exceptions to this.

In Metro Manila, where 70 percent of water was lost to theft and leaks in the late 90s, reduction in non-revenue water was proposed as a KPI,

Powerful Incentives for Non-Revenue Water Redux



Some CoA Observations of Water Joint Ventures reveal problems:

Even if a Water District had a clear medium-term service level improvement and investment plan — LWUA either does not have the funds, or would not allow the WD to borrow from other creditors.

> i.e. the Water District could not even propose an in-house option that would “compete” against the unsolicited proposal;

The Swiss Challenge, if it happens at all, sticks to the technology proposed by the original proponent because the WD does not have access to expertise to assess alternative technical proposals that would deliver the same KPIs at lower cost.

Failure of Competition in the MWSS Privatization Case

Many Bidders

Very low Dive Bids surprised the government

Post-contractual contract re-negotiation (tariffs and performance targets) — revised the profit rate upwards even before the first rate re-basing.

Is this happening in the water districts?

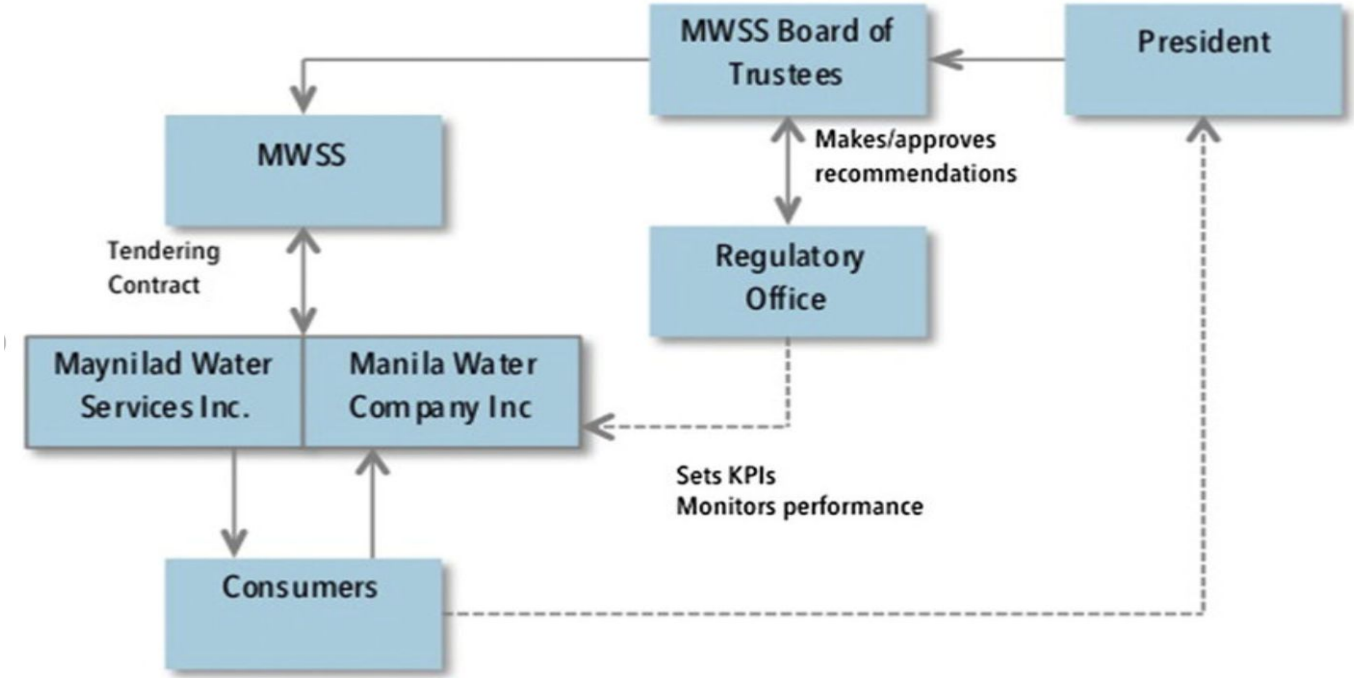
Some CoA Observations of Water Joint Ventures reveal problems:

LGUs and their constituencies have no say in the formulation, monitoring and enforcement of JV agreements or concessions;

NWRB or LWUA might or might not be able to give local stakeholders a say when contract-based tariff escalations are implemented by the WD. One WD is contesting NWRB's authority to approve tariffs when JV agreements have provisions on how tariffs are to be adjusted.

A majority of CoA observations reveal that there are no WD staff trained and authorized to monitor private sector compliance with KPIs and investment schedules. WD people are trained as service providers, not as regulators

The MWSS Governance Set-up (Robust)



Solution Concepts — to ensure prudence, good behavior and fairness of contracts

NEDA may need to play a gate-keeping role to ensure that Joint Ventures result in beneficial and commercially viable cooperation. It should also trace the evolution of contractual relations to see to it that the value promised at the beginning is only enhganced, rather than diminished by contract changes.

PPP Center may need to develop contract templates — to make sure that minimum elements are present, including well defined KPIs and incentives for performance, as well as default operational guides so that there is no dispute int the measurement of KPIs.

Solution Concepts — possibly requiring revision of NEDA JV Guidelines

The GCG should ensure that the right personnel and officers are in place in the water district to ensure smooth administration of the contract and evidence-based reviews and revisions of contract assumptions, which happens to 40 perent of concessions globally within the 1st 5 yrs.

The NWRB, in accordance with the mandate passed on to it by the Public Service Act must assess the tariff implications of the JV Concession agreements;

Solution Concepts to ensure that competitive forces are at work to maximize cost-savings

To avoid dive bids that will not be viable anyway — the lowest bidder wins, but the contract to be awarded will feature the second lowest bid. This is also called the Vickrey truth serum — it reduces underhanded efforts at post bid contract changes that erode agreed service level improvements;

To strengthen the viability of technical and financial bids — asset condition reports done by reputable accounting firms should be used as the basis for technical proposals. Quite importantly, this also allows JV contracts to reflect the value of Water District Assets (entitled to part of the financial return) that contribute to the performance of a concession agreement.

Solution Concepts to ensure that competitive forces are at work to maximize cost-savings

A la Vietnam — existing small water service providers within the service area of a water district should be invited to augment water supplies of Water Districts up, provided that these supplies are safe, reliable, do not deplete acquifers and are not expensive;

A la Kisumu (an African City) and a la Manila Water — district sub-metering needs to become standard practice, beginning with areas that have the highest non-revenue water levels. Because NRW is due to both leaks and pilferage, community collective action combined with engineering solutions b will typically outperform purely private sector engineering solutions. Community associations should bid for sub-concessions and be rewarded for converting lost water into revenue generating water. Investments in new bulk water sources can then be scaled down.

To generate a non-private sector financing option

LWUA should be capitalized, but should focus on giving concessional loans to non-viable water districts that need to achieve scale and move out of the persistent low service quality, low price equillibrium.

Local Government units, after the manner of Zamboanga City, ”invest” in water districts by generating suppplies and subsidizing distribution and storage in the underserved baranngays. These should be jointly planned with the Water Districts and then turned over to the water district — and then, as mandated by PD 198, the Water District should remit a percentage of its revenues to the LGU in lieu of LGU shares of stock. The cycle of LGU investments would then persist.